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IN THE

Supreme Court of the United States

October Term, 1952.
No. 481

RAYMOND W. CLAWSON,

Petitioner,

vs.

UNITED STATES OF AMERICA.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit and Brief.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, Raymond W. Clawson, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in this case November 5, 1952 [834-839].

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1), Section 240 of the Judicial Code.

The Court of Appeals for the Ninth Circuit affirmed a judgment of conviction on August 28, 1952 [834-838]. Petitioner filed for rehearing, which was duly entertained and denied on November 5, 1952 [839]. This petition was filed within thirty days in accordance with the rules. Issuance of the mandate has been stayed by the Court of Appeals for the Ninth Circuit.

Opinion Below.

There was no opinion in the District Court. The opinion of the Court of Appeals (Mathews, Bone and Orr, Circuit Judges) has not yet been reported, and is contained in the record at pages 834 to 837.

Statute Involved.

The statute under which petitioner was prosecuted, convicted and sentenced, Section 145(a) of the Internal Revenue Code, insofar as applicable here provides:

> *"Failure to file returns.* * * * Any person required under this chapter * * *, or required by law or regulations made under authority thereof to make a return * * * who wilfully fails to * * * make such return * * * at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, * * *."

Questions Presented.

1. Whether the record contains that minimum quantum of evidence which the law requires to sustain a verdict of guilty upon the offense charged in this case.
2. Whether petitioner was entitled to a bill of particulars.
3. Whether petitioner's motion for return of illegally seized property and for the suppression of evidence was improperly denied.
4. Whether petitioner was subjected to a denial of due process when he was refused the opportunity of obtaining evidence to refute matters as to which he was caught by surprise.
5. Whether petitioner was denied due process by virtue of the action of the prosecutor in shifting his theory of the case from the *"alter ego"* theory to the "constructive dividend" theory after all of the evidence was in the record.
6. Whether petitioner was prejudiced by certain instructions to the jury offered by the prosecution.
7. Whether petitioner was prejudiced by the failure to give to the jury certain instruction requested by him.
8. Whether it is permissible to admit into evidence in a criminal cause second-degree hearsay testimony and the hearsay medical records which were privileged and which the prosecution illegally obtained and utilized?

Statement

The judgment of the Court of Appeals herein affirmed a judgment of conviction of petitioner for violation of Section 145(a) of Title 26, U. S. Code. The information contained one count, charging petitioner with failure to file an individual income tax return for the taxable year 1946. Trial was had before a jury, which found petitioner guilty. The District Court sentenced petitioner to imprisonment for ~~one year.~~

The Court of Appeals here has apparently held, among other things, directly or by inference,

(a) that the legal test of sufficiency of evidence to sustain a criminal conviction is whether the jury has brought in a verdict of guilty. In its opinion the Court of Appeals said "That the prosecution successfully carried this burden [of establishing any money received as being true income (836)] is made evident by the verdict of the jury, * * *" [837];

(b) that hearsay evidence offered by the prosecution is admissible in a criminal case;

(c) that it is unnecessary for the trial judge in a criminal case to instruct the jury upon the law applicable to facts which the jury might find in support of the defendant's theory of the case;

(d) that the owner of a majority of the stock of a duly organized and going corporation must report *its* income on his individual income tax return;

(e) that income of a corporation may be taxable as corporate income and simultaneously as individual income of the owner of the majority of the corporation's stock;

(f) that the prosecutor is at liberty to offer otherwise inadmissible evidence under the *alter ego* theory, and then abandon the theory but not the evidence in favor of a mutually exclusive theory as to the nature of funds ultimately charged to the taxpayer as income;

(g) that a family-owned or closed corporation is *per se* the *alter ego* of its stockholders for income tax purposes.

The facts, in brief, are as follows:

Petitioner was born in 1906 in San Jose, California, the grandson of Sarah Names of Oakland, California [525]. His grandmother, a wealthy woman, gave to him directly and indirectly and sent to him through the Postal-Telegraph Co., and Western Union Telegraph Co., between $10,000 and $15,000 a year during most of his adult life, until shortly prior to the her death in 1945 [245, 253-254, 329-330, 337-338, 435-449, 473-479, 528-531, 736-742].

Prior to 1944, petitioner did not engage in any gainful employment for more than a brief period [245, 329, 472-475, 528, 736-737, 742]. As one of the concomitants of having a rich and generous grandmother, and also a wealthy wife, petitioner at no time produced any "income" as that term is defined for income tax purposes [329, 339, 530-531, 619-620, 737-742].

Beginning in 1944, petitioner became the stockholder of Clawson Enterprises, Inc., a holding company, incorporated in California in February, 1944 [18; Govt. Ex 1].

In 1944, 1945 and 1946 this Corporation operated a cafe and bar called "Clawson's Restaurant," and, in 1946,

a newspaper, the "Crenshaw-Mirror," and two boats, the "Artemis" and the "Conqueror" [597-600, 743-744].

Petitioner had incorporated Clawson Enterprises, Inc., hereinafter called the Corporation, upon advice of an attorney, Frederick H. Clapp, of Los Angeles [743-744].

Because petitioner had certain personal outstanding debts, he did not wish to jeopardize the interest of the new lenders by placing their money into a corporation owned primarily by himself; therefore petitioner, although he was the prime mover behind Clawson Enterprises, Inc., placed the bulk of the stock in the hands and name of Hicks, who was one of his creditors [221, 229-230, 534-535, 641; Govt. Exs. 1-A, 1-B, 17].

Out of a total of 120 shares, petitioner held one share of the stock in the Corporation, his stepfather owned one share, Kathleen A. Clawson, his wife, one share, and his boyhood school-headmaster Hicks, treasurer and secretary of the Corporation, held 117 shares [198, 215, 218-220, 222, 225, 244, 526, 544, ff.; Govt. Exs. 17, 18].

Petitioner's stepfather, who supplied his and Clawson's mother's money for the liquor license, and also supplied further funds for operating expenses later, held the liquor license in his (stepfather's) own name [509-524, 533-534, 543, 638; Govt. Exs. 40, 49-A, 49-B].

Clawson's Enterprises, Inc., operated "Clawson's Restaurant" as a losing proposition. Instead of returning any profit, it required and received constantly new operating capital. The secretary-treasurer, although he was well aware of the nature of these funds, however failed to enter them all on the Corporation's records [252-253].

The Corporation was and functioned as a bona fide entity. It was duly organized and existed under the laws

of the State of California, with by-laws, stock, etc. [217, 545-547; Govt. Exs. 1, 1-B, 17, 18].

Petitioner testified without contradiction that the Corporation continued to operate after March, 1946 [600, 612]. The Corporation's bank accounts show hundreds of withdrawals and deposits until May 20, 1948 [Exs. F and M, J, K, R].

The Government stipulated that the Corporation was never dissolved [243]. Government witnesses Hicks and Cummins testified that in 1946 Corporation funds were used to purchase and outfit the boat "Artemis" [287-288, 387-389, 558-559, 587; Exs. B, 5]; the Corporation acquired and operated the newspaper "The Crenshaw Mirror" [288, 317-318, 458-459, 587-589, 616-618; Exs. P-1, P-2, P-3, P-4, Q, S, T]. Some of the proceeds from the later sale of the "Artemis" were redeposited into the Corporation's account [402-403].

The Corporation was duly organized and existed under the laws of the State of California, with by-laws, stock, etc. [217, 545-547; Govt. Exs. 1, 1-B, 17, 18].

It had two active bank checking accounts which at times required two signatures for the withdrawal of funds [546; Govt. Ex. 5; Deft. Exs. F, G, M, J, K]. It made hundreds of deposits and withdrawals totalling many thouands of dollars [306-312; Govt. Exs. 20-22, 42-48; Deft. Exs. A-G, J, K, M].

It had books and records [Govt. Exs. 10, 11; 128-132, 199-210, 216, 297, 319-321, 542]. It had officers [128-132, 199-210, 216, 217, 244, 297, 319-321, 542, 545-546] and numerous employees [227, 244, 247; Deft. Exs. E-1 to E-5, H, I, L]. It engaged in various financial and commercial transactions, and paid numerous taxes [*E. g.*, Govt. Exs. 5, 6, 7, 10, 11, 20, 21, 22, 23, 24, 25, 26, 27,

41-A, 41-B, 42-48; Deft. Exs. B, C, D, E-1 to E-5, F, G, H, J, J-1, K, M, N, O].

In order to make certain that the books and records were kept in proper order, that function was delegated to secretary-treasurer Hicks, who had taught mathematics for many years and knew bookkeeping [198-199, 243-246, 286, 552-555; Govt. Exs. 10, 11]. All entries in the books for 1946 were made by Hicks, by his friend Dittmars, and by an accountant, W. Leo, hired by Hicks [198-213, 243, 246-248, 286, 303, 332, 552-555, 618-619].

Petitioner did not handle any of the Corporation's books or records [198, 199, 609].

The capital and operating expenses of between $45,000 to $50,000 of Clawson Enterprises, Inc., for the most part *borrowed money*, had to be repaid at some date subsequent to its initial borrowing [554-555, 610, 695].

There is no evidence in the record to indicate that any of the lenders ever relinquished or forgave their loans to petitioner prsonally or the Corporation.

While petitioner used for his personal expenses some of the money received by the Corporation, such funds were taken in repayment of loans he had previously made to it; moreover, the total never reached the sums he had invested of his own or others' money which he had borrowed to pay the Corporation's expenses.

Petitioner received no salary from the Corporation whatsoever [563]. Petitioner testified, without contradiction, "I took money out sometimes because I felt I could, because I put money into it, but that is all * * *" [563]. Almost from its inception the Corporation was operated at a loss [251-252, 547, 606].

Uncontradicted testimony and record evidence demonstrated that between 1943 and 1946, petitioner loaned to the Corporation more than $45,000, much of which was in part deposited into the Corporation's bank accounts at the Citizens Bank and the Security-First National Bank, and a great part of which petitioner paid directly out of his own pocket for the benefit of the corporation and as loans to it [254-255, 306, 548-549, 552, 555, 560-561, 580-587, 594-598, 600, 606, 610-611, 640; Exs. F, H, M].

This money was obtained by petitioner [542] in the main by gifts from his grandmother (who had supplied him with money for many years) [253-254, 329-330, 337-339, 474-477, 529]; by loans from his prior wife, Phyllis Clawson, in the sum of approximately $15,000 [479-480, 555-557] and for which she received the Corporation's receipts [490, 533]; by loans from his then-wife, Kathleen, in the sum of approximately $20,000 [252-253, 338-339, 530, 532, 548, 565-567, 582, 672-673]; loans and remittances from his mother, in the sum of approximately $16,000-$17,000 [513, 516-517, 254, 435-449, 474]; loans from lending institutions, including the Auto Finance Co., Markwell & Co., and Sunset & Vine Loan Co., to himself and to his wife mainly for the benefit and use of the Corporation [565-566], and loans from outsiders [253].

These outsiders included, among others, witness Mrs. Julia Rudd, who, it is undisputed, in 1945 lent petitioner about $11,500, and in 1946 about $900, to be used in his business [497, 499-500, 543].

And the Superintendent of Western Union Telegraph Co. at Oakland testified without contradiction that petitioner's mother remitted to him many thousands of dol-

lars each year beginning in about 1933 [435-449]. Petitioner's mother had been given this money by her mother, petitioner's grandmother, for transmittal to him [512, 522]. The total sums thus transmitted to petitioner were between $125,000 and $150,000 [513, 523].

In 1946 Phyllis Clawson requested repayment of the funds loaned by her for the Corporation's expenses [381, 481, 555-556]. As a result of this request, and because of O. P. A. price problems, as well as problems relating to supplies [551-552], the restaurant was sold in the spring of 1946 for $40,000 [10-20, 52, 134-135, 216, 228-233, 555; Govt. Exs. 23, 24, 27, 41-A, 41-B].

At first the ultimate purchasers wanted to buy all the *stock* of the Corporation; however, due to its bad financial position, its extensive obligations and outstanding loan indebtedness, the purchasers decided, in consultation with counsel, to buy only its then assets—the restaurant and its fixtures, and to buy also the liquor license [8, 13-15, 556-558; Govt. Exs. 49-D, 49-E]. The sale of these assets was duly recorded on the Corporation's books [133-135; Govt. Exs. 10-11].

Petitioner, in disbursing these corporate funds, did so on behalf of the corporation, in repayment of its debts to himself and the others who had loaned money for its operations. The proceeds of the sale of the restaurant were utilized as follows: $9,500 as a payment on the boat "Artemis" on behalf of the corporation [568-570; Exs. 8-A, 8-B]; $3,000 redeposited into the corporation's account [577, 580, 584-585; Ex. 36]; $5,000 for furniture and for Phyllis Clawson [578; Ex. 37] in partial repayment of the $15,000 (*supra*) she had advanced for the operations of the corporation [578; Ex. 37]; $3,350 to petitioner [580; Ex. 37] in

partial repayment of the $44,000 he had loaned to the corporation.

Later the "Artemis" was also sold. The proceeds of the sale of the "Artemis" were distributed as follows: $8,000 to Kathleen Clawson in repayment of funds advanced by her to the corporation [571-572; Ex. 30]; $25,000 deposited to the account of the corporation [573, 575, 576; Exs. 31-A, 33-A]; $8,000 paid to Vine-Sunset Loan Co. to pay off loans made by Kathleen Clawson, Phyllis Clawson and petitioner, the proceeds of which had been used in connection with the operations of the corporation [573-574]; $8,000 to Markwell & Co. in repayment of loans made by Kathleen Clawson, the proceeds of which were loaned to the corporation [596]; $10,000 to Auto Finance Company to repay loan, the proceeds of which were used for the corporation [574-575, 596].

Petitioner obtained funds for his personal living expenses partly in the form of repayment of loans by him to the corporation after the sale of the restaurant (*supra* and *infra*) and partly from his then wife, Kathleen Clawson, who was the beneficiary of a trust estate, No. B-919, Security-First National Bank of Los Angeles, Sixth and Spring Streets, from which she received about $80,000 while married to appellant [531, 619, 672-675, 676, 679, 684-685].

The total funds taken by petitioner from the corporation for his own use did not at any time even approximate the indebtedness of the corporation to him, of about $44,000. The funds taken by petitioner from the corporation to repay other persons who had advanced money for its operations, were repaid on behalf of the corporation, and, we respectfully submit, cannot be considered as income to petitioner.

ARGUMENT.

The record does not contain that minimum quantum of evidence which the law requires to sustain a verdict of guilty upon the offense charged in this case.

A.

In this, a criminal case, it was clearly not enough for the prosecution to show merely that money came into the hands of the petitioner, but the prosecution was required to demonstrate beyond a reasonable doubt that such funds were in fact, his personal and individual income, and not the income of the corporation. In this the prosecution failed.

The fact that income is received by the corporation in which petitioner had an interest or even which he controlled, did not constitute income to him personally so as to make it obligatory upon him to file an *individual income tax return* (see *e. g., Comm'r Int. Rev. v. Moline Properties,* 131 F. 2d 388, 389, 63 S. Ct. 1132; *Eisnar v. Macomber,* 40 S. Ct. 189; *Interstate Transit Lines v. Comm'r,* 63 S. Ct. 1279; *Harwood v. Eaton,* 68 F. 2d 12, cert. den. 54 S. Ct. 715; *Comm'r Int. Rev. v. Montgomery,* 144 F. 2d 313, 315.)

Manifestly, no funds can constitute income to petitioner personally if the funds he received from or through the corporation constituted: repayment of loans made to it by petitioner out of his own funds; or funds borrowed by him from other persons for the corporation's use or benefit; funds to be used by petitioner on behalf of the corporation; or even funds received by petitioner improperly, which funds are in fact the property of the corporation; loans to petitioner by the corporation

or by other persons. (*Weaver v. Comm'r Int. Rev.*, 58 F. 2d 755; *Trippett v. Comm'r Int. Rev.*, 118 F. 2d 764; *Macqueen Co. v. Comm'r Int. Rev.*, 67 F. 2d 857.)

While the Circuit Court agreed with the legal proposition that only *true income* can be considered in determining whether petitioner was obliged by law to file an individual income tax return and that the burden of establishing that funds received by petitioner constituted *income*, was, of course, upon the prosecution, it accepted as income monies which were in fact, and without contradiction, identified as loans, or repayment of prior loans, etc. And it disregarded the basic proposition that any circumstantial evidence equally consistent with the hypothesis of innocence as with guilt, must be viewed as supporting innocence and that the burden of establishing that petitioner acted "wilfully," that is, with the specific intent as regards the corrupt and criminal motive to avoid an obligation known to exist with which the act or omission was done, etc., was also upon the prosecution. (*United States v. Murdock*, 54 S. Ct. 223; *Spies v. United States*, 63 S. Ct. 364.)

The Circuit Court in fact disregarded its own decision in *Weaver v. Comm'r Int. Rev.*, 58 F. 2d 755 (C. C. A. 9), where the Circuit Court held in part, that

> "* * * The stockholders who advanced the money might be estopped from claiming a return of the money but as between the government and the stockholders the actual transactions controlled in determining whether or not the money thus advanced and repaid is income within the meaning of the revenue act."

As stated in *Bryan v. United States,* 175 F. 2d 223, 225:

> "'* * * it was essential for the Government to present evidence that excluded, or tended to exclude, all other available sources from which the additional funds expended could have been derived * * * The evidence, being circumstantial, must exclude every reasonable hypothesis other than the guilt of the Defendant * * * the case should not have been submitted to the jury since it did not exclude the hypothesis that the funds used in making some of the expenditures might have been from sources other than current business income.'"
>
> "* * * The defendant is not compelled to take the witness stand; he is not compelled to make proof that he is innocent, but he must be proved guilty by the evidence beyond all reasonable doubt, and where there is doubt that all the assets of defendant are included in the government's computation of net worth, it follows that its computation can not be relied on."

In *Spies v. United States,* 63 S. Ct. 364, 317 U. S. 492, 87 L. Ed. 418 (N. Y., 1943), this Court held that it would not assume that mere knowing and intentional default in payment of income tax, where there had been no wilful failure to disclose liability, was intended to constitute a criminal offense of any degree under sections of the Revenue Act referring to "wilful" failure to pay tax or make return or attempt to defeat tax, but that the Court would expect "wilfulness" to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.

The Internal Revenue agents who were used as "expert" witnesses admittedly did not examine all of the per-

tinent financial dealings of the corporation or of petitioner personally [342 *ff*].

They were apparently content to make only a partial investigation, because of their adoption of the legal theory that all that was needed in this case was a lifting of the corporate veil, partially [388-390].

The theory of the agents in investigating the case was to treat the corporation as non-existent, as the *"alter ego"* of petitioner, and to treat its operations as though they were the personal business transactions of petitioner as an individual [343-349], without any audit of the corporation's books and records, which the agent merely "looked over" [344]. They did not examine the bank ledger sheets and records to ascertain the source of the money deposited to the corporation's account or to ascertain the nature of the financial transaction [345-349, 353, 368-369, 375-376, 378]. Nevertheless they were permitted by the trial court to state conclusions and opinions on a basis lacking in required evidentiary support.

The agents did not deduct from the total figures any loans to the corporation [395, 398, 400, 408-409, 410, 412, 421, 424], although they admitted that "if he [petitioner], loaned money to the corporation, part of those withdrawals he made could be applied against the loans that he made to the corporation." [398.] The agents decided that the corporation's bank account was to be treated as though it were petitioner's personal bank account, and made their computations and testified as to findings based upon this hypothesis, as though they were provable facts. [See *e. g.*, 400-404.]

But the prosecution, after the evidence was all in, claimed that it had not relied upon the *"alter ego"* theory at all! [794-795, 801, 806, 807.]

To have offered much of the evidence ostensibly on the *"alter ego"* theory, while in fact not pressing that theory, was highly prejudicial to petitioner, and required reversal of this case.

Moreover, examination of all the evidence clearly shows that it is insufficient to sustain the verdict on any theory.

As early as 1918 this Court recognized the doctrine of separate corporate entity for tax purposes (*Lynah v. Hornby,* 38 S. Ct. 543; *Eisnar v. Macomber,* 40 S. Ct. 189; *Interstate Transit Lines v. Comm'r,* 63 S. Ct. 1279 (1943); *Moline Properties* case, 63 S. Ct. 1132 (1932)). Before a corporate entity can be disregarded, it is obviously not enough that the corporation is organized and controlled, and its affairs so managed as to make it "merely an instrumentality, conduit or adjunct of its stockholders, but it must further appear that they are the business conduits and *alter ego* of one another *and that to recognize their separate entities would aid the consummation of a wrong."* (*Erkenbacker v. Grant* (1921), 200 Pac. 641, cited and approved in many cases.)

With regard to tax matters similar requirements obtain. The corporation as such must be recognized even when wholly owned by persons who would be otherwise taxed individually. (See *e.g., Comm'r Int. Rev. v. Montgomery,* 144 F. 2d 313.)

Even in civil tax matters "the tendency is not to ignore the corporate entity unless it be used to defraud, but rather when natural persons are using corporate forms to do their business, they and their corporations are held to the literal consequences." (*Bancker v. Comm'r,* 76 F.

2d 1, 2, cited with approval in *Comm'r v. Moline Properties,* 131 F. 2d 388, 389 (1942); see also *Herbert v. Riddell,* U. S. D. C., So. Dist. Cal., Feb. 28, 1952.)

And see also *Comm'r v. Court Holding Corp.,* 324 U. S. 331; *Wichita v. Comm'r,* 162 F. 2d 513; *Fairfield S. S. Corporation v. Comm'r Int. Rev.,* 157 F. 2d 321.

But even if petitioner illegally used the proceeds of the sale of the restaurant and the "Artemis," proceeds which he as an officer of the corporation could only dispense legally on its behalf, that income could not be regarded as his individual income for income tax purposes. (*Comm'r v. Wilcox,* 66 S. Ct. 546.)

As in the *Herbert* case, it may here be said that:

> "In seeking to achieve certain business or tax results, the taxpayer is free to choose the form in which he will do business * * * And if, having chosen a form, he actually carries on the business under the structure adopted, the Government cannot deprive him of the benefit of the chosen form * * * So the Treasury Department is not * * * free to disregard the corporate entity where a tax benefit would result to the taxpayer. Conditions must exist which warrant the conclusion that a particular organization served *no actual business purpose.* Nor, in doing so, can the Treasury Department when dealing * * * with a group of individuals and a corporate entity seize upon common ownership or control as the sole determinant." Citing
>
> *Burnett v. Commonwealth Co.,* 287 U. S. 415;
> *Moline Properties, Inc. v. Conner,* 319 U. S. 436;
> *Inland Development Co. v. Comm'r,* 10 Cir. 120 F. 2d 986.

B.

In its opinion, the Court of Appeals stated that all other errors specified by petitioner are without merit. Petitioner respectfully requests reconsideration of this conclusion.

1. Petitioner sought by motion a bill of particulars; the motion was denied [Cr. 4-8].

Had petitioner been furnished a bill of particulars, he could have met various issues which were raised for the first time at the trial, including the mutually-exclusive theories of the prosecution as to the corporate income of Clawson Enterprises, Inc., constituting (1) income to petitioner under the *alter ego* theory, requiring non-recognition of the separate existence of the corporation, and (2) income to petitioner under the constructive dividend theory requiring recognition of the separate existence of the corporation. Not until almost the very end of the trial in this case did the Government reveal its position that it was trying a constructive dividend case, rather than an *alter ego* case. In fact, much damaging evidence which was proper under the *alter ego* theory, but not the constructive dividend theory, was admitted. All of this constituted a denial of due process.

2. The testimony of Dr. George O. Whitecotton [647-665] and the medical records [Govt. Exs. 52-54] were purely second-degree hearsay evidence not relating to petitioner but *to his grandmother.*

This hearsay testimony was highly prejudicial to petitioner and should not have been admitted, since it constituted an attempt to contradict indirectly his and other witnesses' testimony to the effect that he and his wife had borrowed or received extensive funds from his grandmother which were thereafter loaned by him and his wife

to Clawson Enterprises, Inc., as to which he later received repayment. These repayments of loans were part of the sums credited by the Government to petitioner personally as income.

And the trial judge refused to grant a continuance to permit petitioner to gather evidence to rebut this surprise hearsay testimony.

3. Various instructions given by the trial court should not have been given, we submit. Others offered by petitioner and rejected by the trial court were essential to his case. In both sets of instances petitioner was gravely prejudiced to an extent requiring reversal of his conviction. We point to but a few selected instances.

(a) GOVERNMENT'S INSTRUCTION No. 2.

> "If you find that there were any gains, profits, or income received by the defendant which were not reported, *it makes no difference as far as the question of taxability is concerned whether such income was lawfully received or unlawfully received, inasmuch as both were taxable and should have been reported.*" (Italics added.)

We respectfully submit that this is not the law (*Commissioner v. Wilcox,* 66 S. Ct. 546). Plainly the jury was misinstructed here and its verdict could have been predicated upon acceptance and application of this instruction.

(b) GOVERNMENT'S INSTRUCTION No. 9.

> "Every person subject to income tax, 'except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the busi-

ness of growing and selling products of the soil, *shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters* required to be shown' in an income tax return."

No issue is present in this case as to failure to "keep such permanent books of account or records * * *" etc. Much evidence was introduced by the prosecution in this connection. Wilful failure to comply with this regulation can be the basis of a criminal prosecution. However, it was not the basis of the instant prosecution. The jury plainly could have been led to believe by this instruction that failure to keep sufficient books was the gravamen of the offense.

(c) GOVERNMENT'S INSTRUCTION No. 10.

" 'Wilful,' in the statute which makes a wilful attempt *to evade taxes* a crime, refers to the state of mind in which the act of evasion was done. * * *"

This was not a tax evasion case under Section 145(b) of the Internal Revenue Code. The language quoted could easily have misled the jury as to the issues before it, and may have been responsible for the conviction in this case.

Those instructions which the trial court refused to give to the jury included the following:

(d) DEFENDANT'S INSTRUCTION No. 3.

"It is immaterial whether or not Clawson Enterprises, Inc., had any income during 1946."

(e) DEFENDANT'S INSTRUCTION No. 9.

"Nor can the receipts of a corporation be chargeable to its stockholders or sole stockholder for income tax purposes."

Clawson Enterprises, Inc., was not on trial; its *income* had no bearing on this case. The voluminous testimony as to the corporation's income, based on the *alter ego* theory subsequently disavowed by the prosecution, prejudicially confused the jury as to the issues before it, namely whether petitioner *as an individual* had a gross income requiring the filing of an individual income tax return by him.

(f) DEFENDANT'S INSTRUCTION No. 12.

"You cannot find that the defendant acted wilfully if he did not understand clearly the requirements of the law as they applied to him in connection with income tax returns for 1946."

(g) DEFENDANT'S INSTRUCTION No. 13.

"You cannot find that the defendant acted wilfully if he is shown to have honestly believed that under the circumstances presented in this case he did not have to file any return for 1946, or if he relied upon the advice of an accountant or an attorney as to his rights and obligations in that regard."

These instructions were essential to clarify the wilfulness element of the case. Petitioner was clearly confused as to his duties in the premises. He believed that no return under any circumstances was required unless he had net income—and there was no net income. The jury should have been instructed on the law relating to petitioner's defense.

(h) DEFENDANT'S INSTRUCTION No. 18.

"Money misappropriated, embezzled or stolen does not constitute income, either gross or net, to the person who misappropriates, embezzles or steals the money in question."

This instruction paraphrases this Court's holding in *Commissioner v. Wilcox* (1946), 327 U. S. 404, 66 S. Ct. 546. Petitioner was entitled to have the jury instructed as to all the law applicable to him under the facts which the jury may have found to exist. (See also Govt. Instr. No. 2, *supra.*)

(i) DEFENDANT'S REQUESTED INSTRUCTION No. 28.

"The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."

(j) DEFENDANT'S REQUESTED INSTRUCTION No. 29.

"The corporate form must be unreal or a sham before the Treasury may disregard it. Whatever may have been the purpose of organizing the corporation, so long as that purpose is the equivalent of business activity, or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity" [C. T. 24].

These rejected instructions correctly reflect those principles of law which are favorable to petitioner, and the instructions given did not present the law as it applied to the divergent views as to the facts before the jury.

4. Petitioner was denied due process by virtue of the action of the prosecutor in shifting his theory of the case after all of the evidence was in the record.

Much of the evidence came into the record on the *"alter ego"* theory. This theory was abandoned by the Government. The trial court did not strike this evidence. The presence of this evidence and the shift in the prosecution's theories resulted in a denial of due process.

5. The trial court erred prejudicially in admitting into evidence the second-degree hearsay testimony of Dr. George O. Whitecotton [647-665], and in admitting the hearsay medical record document. [Govt. Exs. 52, 53, 54.] Also, these documents were privileged since the person to whom the medical records referred, who was then 86 years of age [662] had not waived her privilege: the prosecution therefore illegally obtained and utilized these documents [648].

Moreover, the 1937 matter had no relation to any issue before the Court.

The trial court received this document in evidence [Govt. Ex. 52; 668] and permitted Dr. Whitecotton to testify concerning its contents although he admitted that the financial information furnished therein was based possibly on Mrs. Name's statements, and he admitted also that the very hospital record he was using as the sole basis for his testimony expressly stated that Mrs. Names was then 86 years of age, "senile," "confused" [647-648, 658 *ff*], "incoherent," "unreliable," and "forgetful" to the extent that she even disclaimed having a daughter, petitioner's mother!

6. The District Court erred in refusing to accord to petitioner the opportunity to obtain evidence to refute

matters improperly placed before the jury, as to which petitioner was caught by surprise, as developed by the hearsay testimony of Dr. Whitecotton and by Government Exhibits 52, 53 and 54 [701-702, 712-713, 720-723, 731, 761-765, 785-786].

Conclusion.

The petition for a writ of certiorari should be granted.

Questions presented herein embody questions of federal law which apparently have not been settled by this Court. The decision herein sustaining conviction is based in part upon hearsay evidence and is in violation of petitioner's rights under the Constitution of the United States. The decision herein appears to be at variance and in conflict with various decisions holding that a closed corporation is a separate entity distinct from its stockholders for income tax purposes. There was no showing by the prosecution that any tax was due and owing which is necessary before a conviction can be had under Section 145(a), Title 26, U. S. Code.

We respectfully submit that the writ should issue.

RAYMOND W. CLAWSON,
Petitioner.

WILLIAM STRONG,
Attorney for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 481

RAYMOND W. CLAWSON, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (R. 834-837) is reported in 198 F. 2d 792.

JURISDICTION

The judgment of the Court of Appeals was entered on August 28, 1952. (R. 838.) A petition for rehearing was denied November 5, 1952. (R. 839.) The petition for a writ of certiorari was

filed on December 4, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1). See also Rule 37(b)(2), Federal Rules of Criminal Procedure.

QUESTIONS PRESENTED

1. Whether the evidence was sufficient to sustain the verdict.

2. Whether the trial court erred in refusing to order a bill of particulars.

3. Whether the trial court correctly instructed the jury.

4. Whether there was error in the admission of the contents of county medical records.

STATUTE INVOLVED

INTERNAL REVENUE CODE:

Sec. 145 (as amended by Section 5(c), Current Tax Payment Act of 1943, c. 120, 57 Stat. 126). PENALTIES.

(a) *Failure to File Returns, Submit Information, or Pay Tax.*—Any person required under this chapter to pay any estimated tax or tax, or required by law or regulations made under authority thereof to make a return or declaration, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any estimated tax or tax imposed by this chapter, who wilfully fails to pay such estimated tax or tax, make such return or declaration, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided

by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution.

* * * *

(26 U.S.C. 1926 ed., Sec. 145.)

STATEMENT

Petitioner was charged in an information filed March 14, 1950, with wilfully failing to file any individual income tax return for the year 1946. (R. 2.) He was tried by a jury which returned a verdict of guilty. (R. 31.) After denying petitioner's motion for a new trial (R. 36), the trial court sentenced petitioner to serve one year's imprisonment. (R. 37-38.) The judgment was affirmed by the Court of Appeals for the Ninth Circuit (R. 838) and a rehearing was denied. (R. 839.)

The Government's evidence may be summarized as follows: In November 1943 petitioner purchased a restaurant (R. 276-278) for the sum of $11,000 (R. 281, 638-639), making a down payment of $5,300 which he claimed he received from his wife but which was in fact his own money (R. 639, 640). The balance of $5,700 was to be paid in monthly installments. (R. 41, 44, 639.) Petitioner concealed his ownership of the restraurant and its liquor license by putting them in the name of Waldemar Johanson, his stepfather (R. 534, 607) and his reason for doing so was that he had been convicted of a felony (R. 637-638).

In February 1944, petitioner organized a cor-

poration under the name of "Clawson Enterprises, Inc.". The first and only directors and officers were: petitioner, president and director; Kathleen Clawson, his wife, vice-president and director; Charles E. Hicks, secretary and treasurer; Waldemar Johanson, director. (R. 835.) Although one share of stock each was issued to and in the name of petitioner, Waldemar Johanson and Kathleen Clawson, delivery was never made and the stock remained in the stock book. (R. 835.) Some 117 shares were put in the name of Hicks, who was represented to the Commissioner of Corporations for California as the owner of the restaurant equipment which was being transferred to the corporation in exchange for the 117 shares of stock. (R. 835.) Hicks, however, merely held the stock as nominee for petitioner who actually owned the restaurant equipment. (R. 219-220, 331-332, 641, 707, 835.) In March 1946 all of the assets of the corporation were sold for $40,000 cash, the corporation ceased to do business, and no further directors' meetings were held. (R. 150, 401, 835.) Petitioner then used some of the cash for his personal expenses, drawing checks upon the corporation's bank account to pay his rent, life insurance premiums, clothing and hotel bills and other personal expenses, and between May and December 1946 he spent a total of $11,212.05 for such purposes. (R. 625-636, 699, 700, 835.) A further part of the $40,000 received on the sale of the assets of the corporation was spent for the purchase of a yacht in March 1946 for $9,500 (R. 697, 835),

for $8,782.60 worth of improvements on this yacht (R. 60-75, 835), and for a payment of $12,000 to petitioner's ex-wife to purchase a home and furniture (R. 481, 555-556, 580, 835). The yacht which petitioner had purchased in his wife's name (R. 27) was sold by petitioner in September 1946 for $57,750, and he had the checks made payable to himself, explaining to the purchaser that the yacht was in his wife's name only for business reasons. (R. 26, 27, 30, 31, 334, 836.) Petitioner used part of the $57,750 for the purchase of another yacht for $16,750 in November, 1946 (R. 597), and to pay off $27,000 in personal indebtedness (R. 82, 102, 107-120, 574, 699, 836). Thus in 1946 petitioner received $24,416.66 in constructive dividends from the proceeds of the sale of the assets of the corporation (R. 388-399), and a long-term capital gain of $20,377.35 from the sale of the first yacht. On a community property basis, petitioner had gross income in at least the amount of $22,397.01 for the year 1946 (R. 390, 418). He admitted that he was aware of the requirement that he file an income tax return. (R. 622, 691.) He did not, however, file a return for the year 1946 although his gross income was vastly in excess of the minimum $500. (R. 620-622, 691.)

ARGUMENT

1. In order to sustain a conviction for wilful failure to make a return, it is necessary for the Government to establish (1) that the petitioner was a person required by law to make a return for the

taxable period; (2) that he failed to file a return at the time required by law; and (3) that the failure to file was wilful. *United States* v. *McCormick*, 67 F. 2d 867, 868 (C.A. 2d), certiorari denied, 291 U.S. 662. Every individual having for the taxable year 1946 a gross income of $500 or more was required to make a return on or before March 15, 1947. Section 51(a), Internal Revenue Code, as amended by Section 11(a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231; and Section 53(a)(1), Internal Revenue Code. The evidence summarized above establishes that there was obviously ample support for the verdict. Petitioner seems to be arguing that defense evidence must be accepted to the effect that the monies he received were returns of capital, repayment of loans, funds borrowed by him, or funds belonging to the corporation or others. The jury, however, rejected his version of the facts. Whether petitioner be considered the *alter ego* of the corportion or the recipient of constructive dividends as a stockholder, he clearly received income, individually, in amounts which required him to file an income tax return for the calendar year 1946. *Currier* v. *United States*, 166 F. 2d 346, 348 (C.A. 1st). And the trial court properly instructed the jury on both of the possible interpretations of petitioner's relationship to his corporation as developed in the evidence. (R. 820, 823-824.)

2. The Court of Appeals decided, without discussion, that there was no merit in the other alleged errors claimed by petitioner. (R. 837.) We agree.

Petitioner contends that the trial court erred in denying his motion for a bill of particulars. He argues that as a result he was unprepared to meet the alleged shift in the Government's theory of prosecution from the *alter ego* theory to the constructive dividend theory. But there was no shift in the theory of the case. Rather, as already noted, the evidence is susceptible of two possible interpretations of petitioner's true relationship to his corporation. On either, as the court below stated, "the corporation, created by [petitioner] was a mere dummy. The fact, and not the form, is decisive. [Petitioner] himself was the real owner of all of its capital stock. He himself controlled the corporation. He commanded the income." (R. 837.) The trial court obviously did not abuse its discretion in denying a bill of particulars.

3. It was clearly proper, by way of rebuttal of the claimed receipt by the petitioner's corporation of large sums of money from his grandmother (R. 528-529), to introduce county medical records showing that the grandmother was a charity patient of a county hospital during the period involved (R. 647-665). Petitioner fails to explain how the testimony of the county medical director and the county medical records (being records kept in the regular course of business) were immaterial or irrelevant for the purpose for which they were adduced.

4. Nor was it error, as petitioner claims, to deny him a continuance at the close of the evidence to enable him to make a highly speculative investiga-

tion for cumulative evidence in a further attempt to explain away the effect of the county medical records relating to his grandmother. (R. 785-786.) There was no indication of what evidence might have been secured. This was peculiarly the type of question as to which the trial judge was entitled to exercise a sound discretion.

5. Petitioner complains of the Government's requested instructions which he designates as numbers 2, 9 and 10. Number 2, which proposed that the jury be instructed that any income found to be received was taxable whether lawfully or unlawfully received (R. 29), does not appear in the charge, and the record shows it to have been refused (R. 16). Number 9 was given in substance. (R. 817-818.) It relates to the necessity for keeping sufficient records for income tax return purposes as prescribed by Treasury Regulations, and was clearly accurate and pertinent to the issue of intent. Number 10 referred to the term "wilful" in the evasion statute, Section 145(b), Internal Revenue Code, and, in its context in the charge (R. 816), was plainly used illustratively and could not have been the basis for confusion. The defendant's instructions numbered 3, 9, 12, 13, 18, 28 and 29 were either inappropriate or were given in substance in the charge.

CONCLUSION

The decision of the court below is correct and presents no conflict of decisions or any question of general importance warranting further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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